INDEX

	Page
Opinions below	1
Jurisdiction	1
Question presented	2
Statute and Regulations involved	2
Statement	5
Argument	7
Conclusion	13

CITATIONS

CASES:

Amalgamated Housing Corp. v. *Commissioner*, 37 B.T.A. 817, affirmed, 108 F. 2d 1010 10

Better Business Bureau v. *United States*, 326 U. S. 279 ..... 8, 11

Co-Operative Oil Ass'n v. *Commissioner*, 115 F. 2d 666 12

Jockey Club v. *Helvering*, 76 F. 2d 597 11

Northwestern Jobbers' Credit Bureau v. *Commissioner*, 37 F. 2d 880 11

Trinidad v. *Sagrada Orden*, 263 U. S. 578 11

United States v. *Pickwick Electric Membership Corp.*, 158 F. 2d 272 12

West Side Tennis Club v. *Commissioner*, 111 F. 2d 6, certiorari denied, 311 U. S. 674 11

STATUTE:

Internal Revenue Code, Sec. 101 (26 U.S.C. 1946 ed., Sec. 101) .. 2, 7

MISCELLANEOUS:

Treasury Regulations 111:

Sec. 29.101(8)-1 ..... 3, 10

Sec. 29.101(12)-1 ..... 4, 7

In the Supreme Court of the United States

OCTOBER TERM, 1950.

No. 631

CONSUMER-FARMER MILK COOPERATIVE, INC.,
Petitioner

v.

COMMISSIONER OF INTERNAL REVENUE

On Petition for a Writ of Certiorari to the United States Court of Appeals for the Second Circuit.

BRIEF FOR THE RESPONDENT IN OPPOSITION.

OPINIONS BELOW.

The findings of fact and opinion of the Tax Court (R. 3-18) are reported at 13 T. C. 150. The opinion of the Court of Appeals (R. 36-42) is reported at 186 F. 2d 68.

JURISDICTION.

The judgment of the Court of Appeals was entered December 27, 1950. (R. 43.) The petition

for certiorari was filed March 23, 1951. The jurisdiction of this Court is invoked under 28 U.S.C., Section 1254.

QUESTION PRESENTED.

Whether the taxpayer is exempt from taxation under Section 101(8) of the Internal Revenue Code, which grants tax-exempt status to civic leagues or organizations "not organized for profit but operated exclusively for the promotion of social welfare."

STATUTE AND REGULATIONS INVOLVED.

Internal Revenue Code:

SEC. 101. EXEMPTIONS FROM TAX ON CORPORATIONS.

> The following organizations shall be exempt from taxation under this chapter—
>
> * * * * * *
>
> (8) Civic leagues or organizations not organized for profit but operated exclusively for the promotion of social welfare, or local associations of employees, the membership of which is limited to the employees of a designated person or persons in a particular municipality, and the net earnings of which are devoted exclusively to charitable, educational, or recreational purposes;
>
> * * * * * *
>
> (12) Farmers', fruit growers', or like associations organized and operated on a cooperative basis (a) for the purpose of market-

ing the products of members or other producers, and turning back to them the proceeds of sales, less the necessary marketing expenses, on the basis of either the quantity or the value of the products furnished by them, or (b) for the purpose of purchasing supplies and equipment for the use of members or other persons, and turning over such supplies and equipment to them at actual cost, plus necessary expenses. * * *

* * * * * *

(26 U.S.C. 1946 ed., Sec. 101.)

Treasury Regulations 111, promulgated under the Internal Revenue Code:

Sec. 29.101(8)-1 [As amended by T. D. 5458, 1945 Cum. Bull. 45]. *Civic Leagues and Local Associations of Employees.*—Civic leagues entitled to exemption under section 101(8) comprise those not organized for profit but operated exclusively for purposes beneficial to the community as a whole, and, in general, include organizations engaged in promoting the welfare of mankind, other than organizations comprehended within section 101(6). Certain local associations of employees are also expressly entitled to exemption under section 101(8). The Internal Revenue Code prescribes as conditions to exemption (1) that the membership of such an association be limited to the employees of a designated person or persons in a particular municipality, and (2) that the net earnings of the association be devoted exclusively to charitable, educational, or rec-

reational purposes. See section 29.101(6)-1 with reference to the meaning of "charitable" and "educational" and section 29.101(10)-1 as to the meaning of "local" as used in section 101.

Sec. 29.101(12)-1 [As amended by T. D. 5458, *supra*]. *Farmers' Cooperative Marketing and Purchasing Associations.*—(a) Cooperative associations engaged in the marketing of farm products for farmers, fruit growers, livestock growers, dairymen, etc., and turning back to the producers the proceeds of the sales of their products, less the necessary operating expenses, on the basis of the products furnished by them, are exempt from income tax. For instance, cooperative dairy companies which are engaged in collecting milk and disposing of it or the products thereof and distributing the proceeds, less necessary operating expenses, among the producers upon the basis of the quantity of milk or of butter fat in the milk furnished by such producers, are exempt from the tax. If the proceeds of the business are distributed in any other way than on such a proportionate basis, the association does not meet the requirements of the Internal Revenue Code and is not exempt. In other words, nonmember patrons must be treated the same as members in so far as the distribution of patronage dividends is concerned, that is, if products are marketed for nonmember producers, the proceeds of the sale, less necessary operating expenses, must be returned to the patrons from the sale of whose goods such pro-

ceeds result, whether or not such patrons are members of the association. * * *

STATEMENT.

The facts, which are not in dispute, were found by the Tax Court as follows:

Taxpayer was organized as a non-stock producer-consumers' cooperative. Although its purpose in organizing was stated in the certificate of incorporation as being (R. 4): "for mutual help, not conducted for profit," it was organized to return a reasonable profit which, after reserves, was to be distributed to the consumers and farmers as patronage dividends and to be used for educational purposes. (R. 6.)

Only a small percentage of the patronage dividends declared for consumers is paid because of the small number of consumers who apply for dividend payments. In accordance with taxpayer's by-laws, the unclaimed consumer dividends are transferred to the general reserve fund after one year from the date of declaration. Farmer members, however, have received all dividends declared for them. Taxpayer's consumer dividend record from 1938 through the taxable year in question shows $39,922.53 set aside for consumer dividends during the six-year period and only $3,050.25 paid to consumers during that period. (R. 7.)

Taxpayer's by-laws may be amended by its members. Three percent of the members, or 300 mem-

bers if the membership exceeds 10,000, constitutes a quorum. (R. 7.)

Taxpayer's operations consist of handling and distributing milk from its two country plants through some 500 distributing centers to retail selling points throughout New York City. During the taxable year ended September 30, 1943, taxpayer sold fifteen million quarts of milk. (R. 8.)

Taxpayer owns substantial assets, a large portion of which were obtained by taxpayer by appropriating unredeemed consumer dividends which had been converted into the general reserve fund. (R. 8.)

Taxpayer reported a gross income of $370,133.90 during the taxable year involved. (R. 8.)

Through its officers, taxpayer has sought to improve the milk industry for the benefit of both the farmers and consumers. (R. 9-12.)

For the years ended September 30, 1938, through September 30, 1942, taxpayer set aside for cooperative education a total of $1,015.23, or an average of approximately $200 a year. Thereafter it added no funds to this account. (R. 12.)

For the taxable year ended September 30, 1943, taxpayer deducted from its gross income the sum of $25,920.88 for declared rebates or patronage dividends to consumer patrons. Only $871.05 of the total amount so declared was paid. The remainder lapsed as dividends and was converted into taxpayer's general reserve fund. (R. 12.)

ARGUMENT.

On these facts the Tax Court and the Court of Appeals were clearly correct in denying taxpayer a tax-exempt status under Section 101(8), *supra,* which exempts from taxation "civic leagues or organizations not organized for profit but operated exclusively for the promotion of social welfare". The decision below raises no novel or substantial question of law warranting review, and involves no conflict of decisions. Contrary to taxpayer's assertion, the case presents no issues as to the status of cooperatives generally under the revenue laws, since the taxpayer concededly does not qualify as a tax-exempt cooperative under Section 101(12),[1] the general provision dealing with cooperatives.

The appellate court's conclusion was predicated primarily on the taxpayer's inability to meet the statutory condition that it be operated exclusively for the promotion of social welfare, since the taxpayer's earnings have been consistently distributed to its producer members, who were its only

[1] It is conceded that taxpayer cannot qualify under Section 101(12), *supra,* for the following reasons: The taxpayer is a consumer and producer cooperative whereas Section 101(12) grants exempt status only to producer cooperatives. The taxpayer does not turn back all the profits of sales less the necessary marketing expenses as is required for exempt status under Section 101(12). Moreover, the taxpayer's earnings are not distributed to members and nonmembers alike as the Regulations promulgated under Section 101(12) require. Section 29.101(12)-1 of Treasury Regulations 111, *supra.*

substantial beneficiaries. Taxpayer is able to meet none of the statutory requisites for tax exempt status, since, on the facts found by the Tax Court, it is not a civic league, it was in fact organized for profit, and was operated primarily for the financial gain of its individual producer members, rather than for the promotion of social welfare.

An analysis of taxpayer's activities by the court below led it to the conclusion that taxpayer, which was engaged in the vigorous competitive sale of milk, had not only failed to meet the requirement that it be operated exclusively[2] for the promotion of social welfare, but that, on the contrary, the welfare of its individual producer members was the real concern of the taxpayer; for, while the taxpayer had consistently emphasized its charitable

---

[2] This Court has held in *Better Business Bureau* v. *United States*, 326 U. S. 279, that the use of the word "exclusively" in a context such as this cannot be loosely construed. While in the *Better Business Bureau* case the question involved the construction of Section 811(b)(8) of the Social Security Act, c. 531, 49 Stat. 620, exempting from Social Security taxes organizations "organized and operated exclusively for religious, charitable, scientific, literary, or educational purposes • • •," the language of Section 811(b)(8) and the nature of the problem presented make it clear that with respect to the interpretation of the word "exclusively," this case is governed by the *Better Business Bureau* case. Since Section 811(b) provided that the organization had to be devoted to educational purposes "exclusively," this Court held (p. 283) that "the presence of a single noneducational purpose, if substantial in nature, will destroy the exemption regardless of the number or importance of truly educational purposes."

and educational activities, the principal destination of its profits was apparently the pockets of its producer members. Only a relatively small portion of taxpayer's profits was devoted to educational or other civic purposes. As the Court of Appeals observed, the controlling purpose was "primarily to benefit the taxpayer's membership economically, and only incidentally to further larger public welfare * * *." (R. 40-41.)[3]

The same facts which formed the basis of the holding by the court below that taxpayer was not operated exclusively for the promotion of social welfare impel the conclusion that taxpayer is not, as required by the statute, a civic league. Although the statute contains no definition of civic league, and the court below considered it unnecessary to determine whether taxpayer was a "civic league," the court did observe that the Regulations

---

[3] Taxpayer's by-laws direct the board of directors to "apportion the net earnings from the operation of the business" for the following purposes: (a) at least 10 percent shall be set aside as a general reserve fund; (b) at least 5 percent shall be used for cooperative education; (c) special reserve funds may be established; and (d) patronage dividends shall be payable to consumer members and to producer members (farmers) in the ratio of two to one. The sums set aside for cooperative education in each of the fiscal years 1939 to 1942 were insignificant; in 1939, $350.81; in 1940, $346.82; in 1941, $170.58; in 1942, $147.02. Thereafter taxpayer added no funds to this account, for the reason, as stated in its brief on appeal, that it decided to charge education expenses to general operating expenses. The Tax Court made no finding as to the amount of educational expenses during the taxable year and the record contains no figures as to this.

have construed the term civic league to include "organizations engaged in promoting the welfare of mankind";[4] and that insofar as the operations of the taxpayer were directed to serving the economic welfare of its members—one of the purposes stated in its by-laws—its activities had a much more limited objective than the promotion of the welfare of mankind.[5] Taxpayer, an organization of producers engaged in the vigorous and competitive sale of milk at a profit consistently distributed to its producer members, clearly meets none of the requisites of a "civic league".

Finally, taxpayer does not meet the statutory requirement that it not be organized for profit. Despite the statement in taxpayer's certificate of incorporation that it was not conducted for profit, the Tax Court found as a fact, on the basis of testimony of taxpayer's own witness (R. 13),[6] that taxpayer was organized for a profit-making purpose. The Court of Appeals noted that taxpayer competed vigorously with other milk distributors,

---

[4] Treasury Regulations 111, Section 29.101(8)-1, *supra*.

[5] See *Amalgamated Housing Corp.* v. *Commissioner*, 37 B.T.A. 817, affirmed, 108 F. 2d 1010 (C. A. 2d), holding that an organization established to construct a low-cost housing project was not a civic league.

[6] Testimony of Helen Hall:

> Q. It was not your idea that milk should be sold to the public without a profit being made?
>
> A. No.
>
> Q. It was only to have a reasonable profit?
>
> A. That is right.

and that it has been highly successful in making a profit, as evidenced by the fact that, while it started in 1938 with a borrowed capital of $6,000, its balance sheet as of September 30, 1943, showed assets totalling more than $138,000, and a net worth of more than $15,000. (R. 38.)[7] In the language of this Court, "The commercial hue permeating petitioner's organization" (*Better Business Bureau* v. *United States*, 326 U. S. 279, 283), is reflected both in its corporate activities and in the use to which the profits derived from its activities were devoted.

There is no merit in taxpayer's contention that it is entitled to tax exempt status by virtue of the fact that it was obligated to or did, in fact, distribute a portion of its earnings to its members, and that taxpayer was permitted by the Commissioner to deduct from its gross income the rebate distributions actually paid. The Commissioner's action in allowing such deductions is not relevant here, and cannot operate to change the status of taxpayer for the purposes of Section 101(8). While the administrative practice has been to allow the deduction of such distributions even where the organization could not qualify under

---

[7] Cf. *Better Business Bureau* v. *United States*, 326 U. S. 279; *Trinidad* v. *Sagrada Orden*, 263 U. S. 578; *West Side Tennis Club* v. *Commissioner*, 111 F. 2d 6 (C. A. 2d), certiorari denied, 311 U. S. 674; *Jockey Club* v. *Helvering*, 76 F. 2d 597 (C. A. 2d); *Northwestern Jobbers' Credit Bureau* v. *Commissioner*, 37 F. 2d 880 (C. A. 8th).

the exempting provision, such a practice has never been interpreted to render the organization tax-exempt or to remove from the impact of federal taxation the undistributed earnings. See *Co-Operative Oil Ass'n* v. *Commissioner,* 115 F. 2d 666 (C. A. 9).

There is no conflict with *United States* v. *Pickwick Electric Membership Corp.,* 158 F. 2d 272 (C. A. 6). In that case the taxpayer, a Tennessee electricity membership corporation, organized to provide low cost rural electrification, was not organized for the purpose of earning an ultimate profit. As the Court of Appeals there observed, while it was true that it did collect sums in slight excess of its expenditures, this so-called profit was only a tentative one closely related to the readjustment of rates and there was no intention to make a profit over a long period of time, but merely to maintain a margin of safety. The intention is obviously different here where the taxpayer was organized and operated to earn a substantial profit on its sales. It is also significant that in the *Pickwick Electric* case, patronage refunds, which were actually in the nature of rate adjustments, inured to the benefit of citizens of the community so that the court was inclined to hold that this itself constituted the promotion of social welfare, but here the principal beneficiaries of taxpayer's efficient operations were its producer members. Finally, in the *Pickwick Electric* case the Court of Appeals observed that there were no cash distribu-

tions involved.[8] Each case thus turned on its own facts.

CONCLUSION.

The petition for certiorari should be denied.

Respectfully submitted,

PHILIP B. PERLMAN,
Solicitor General.

THERON LAMAR CAUDLE,
Assistant Attorney General.

ELLIS N. SLACK,
VIRGINIA H. ADAMS,
Special Assistants to the Attorney General.

April, 1951.

---

[8] Moreover, in that case there was no showing that the Pickwick Electric Membership Corporation was engaged in vigorous competition with other companies. No doubt the corporation was organized, at least in part, to service communities which lacked electricity. Furthermore, its business with non-members was expressly limited.

☆ U.S. GOVERNMENT PRINTING OFFICE 1951—942336/P.O. 761